CLERK'S COPY.

Petition and Transcript of Record

Supreme Court of the United States

OCTOBER TERM, 1932

No. 322

THE MASSACHUSETTS MUTUAL LIFE INSURANCE COMPANY, PETITIONER,

vs.

THE UNITED STATES

ON WRIT OF CERTIORARI TO THE COURT OF CLAIMS

PETITION FOR CERTIORARI FILED AUGUST 26, 1932

CERTIORARI GRANTED NOVEMBER 7, 1932

(37,019)

(37,019)

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1932

No. 322

THE MASSACHUSETTS MUTUAL LIFE INSURANCE COMPANY, PETITIONER,

vs.

THE UNITED STATES

ON PETITION FOR WRIT OF CERTIORARI TO THE COURT OF CLAIMS

INDEX

	Original	Print
Petition for writ of certiorari	1	1
Record from Court of Claims	1	5
History of proceedings	1	5
Amended petition	1	6
General traverse	6	9
Argument and submission of case	6	10
Special findings of fact	8	11
Conclusion of law	11	15
Opinion, Littleton, J.	11	16
Judgment	13	19
Clerk's certificate (omitted in printing)	14	
Order allowing certiorari		21

JUDD & DETWEILER (INC.), PRINTERS, WASHINGTON, D. C., AUGUST 31, 1932

[fols. a-1]

SUPREME COURT OF THE UNITED STATES

October Term, 1932

No. 322

The Massachusetts Mutual Life Insurance Company (a Corporation), Petitioner,

v.

The United States

Petition for Writ of Certiorari to the Court of Claims

May it please the Court:

A

Summary Statement of the Matter Involved

The petitioner, a Massachusetts corporation, during the year 1926, and for many years prior thereto, was engaged in the business of making and selling life insurance on the mutual level premium plan in Massachusetts and other states of the United States, and as such was subject to the Revenue Act of 1926 providing for the payment of income taxes for said year. (R. p. 8, Finding 1.)

The policy contracts issued by the petitioner provide that such policy will participate annually in the distribution of the surplus funds of the company; that such dividends, at the option of the insured, among other things, will be paid in cash or may be left with the company to accumulate, subject to withdrawal on demand; and that dividends left [fol. 2] to accumulate will be credited at the end of each policy year with interest at such rate, not less than three per cent, as may be determined by the directors, which interest is subject to withdrawal on demand. (R. p. 10, Finding 8.)

During the year 1926, the period involved in this case, each policyholder leaving dividends with the petitioner to accumulate was given credit in his individual account with the petitioner for his respective part of the interest which accrued thereon during said year and a regular form

notice of the amount so credited was mailed to each such policyholder prior to the close of the year. Such interest was payable on demand and the policyholder was so advised. It was the practice of the petitioner to accept such notice on demand for cash payment of the amount shown therein. (R. p. 8, Finding 1.)

Article 685 of Treasury Regulations 69, pertaining to the Revenue Act of 1926, provides:

"(3) The deduction allowed by section 245 (a) (8) for interest on indebtedness is the same as that allowed other corporations by section 234 (a) (2) (see articles 561 and 121), but this deduction includes item 18 of the disbursement page of the annual statement of life companies to the extent that interest on dividends held on deposit and surrendered during the taxable year is included therein. Dividends left with the company to accumulate at interest are a debt and not a reserve liability."

The special provisions of the 1926 Revenue Act relating solely to life insurance companies, by Sections 244 and 245, provide that gross income shall consist of interest, dividends and rents received during the taxable year, and for the deduction therefrom, including certain items not involving payment, of interest received which is exempt from taxation, dividends received from certain corporations, in- [fol. 3] vestment expenses paid, certain taxes and other expenses paid, during the taxable year. Subdivision (8) of Section 245 (a) provides for the deduction of "All interest paid or accrued within the taxable year on its indebtedness * * *." (44 Stat. L. 47, 48.)

In the determination of petitioner's income tax liability for the year 1926 and the adjudication of its refund claims for said year, the Commissioner of Internal Revenue refused to allow petitioner to deduct from gross income the sum of $544,964.40, which was the amount of interest accrued and credited to its policyholders during said year but not actually withdrawn by them on dividends left with it to accumulate, and which petitioner had deducted in its tax return for said year. Instead thereof, said Commissioner allowed petitioner a deduction of $248,405.97, which was the amount of interest on dividend accumulations actually withdrawn or surrendered by its policyholders during said year, irrespective of the year of origin, and

which petitioner had not taken as a deduction in its tax return. The major portion of this item originated in prior years. (R. pp. 8, 9; Findings 1, 4, 5, 7.)

Petitioner claims it is entitled to recover the tax paid, with interest thereon as provided by law, on the difference between said amount claimed in its tax return and the amount allowed by said Commissioner on a different basis, as a deduction, said difference representing the amount of interest accrued and credited to its policyholders for said year which it has not received as a deduction and which has substantially increased petitioner's income tax liability for said year. After said Commissioner had rejected petitioner's refund claim on account of said increase in [fol. 4] income taxes paid by it for said year, petitioner brought this suit in the Court of Claims, which, on May 31, 1932, decided that petitioner was not entitled to recover and dismissed its petition.

The Question Presented

The sole question here presented is whether interest accrued and credited to petitioner's policyholders during the year 1926 on dividends left with petitioner to accumulate, and unqualifiedly subject to withdrawal on demand, but not actually withdrawn during said year, is deductible from gross income in the computation of net income under the provisions of Section 245 of the Revenue Act of 1926. (44 Stat. L. 47, 48.)

B

Reasons Relied on for the Allowance of the Writ

1. The question here involved is of great public interest and importance, as it very materially affects the revenues of the Government.

2. The question here involved is of great public importance, because it relates to the proper determination of the net income of life insurance companies, which were, during the year involved in this case, and still are, subject to taxation under the Federal Revenue Laws.

3. The question here involved is of great and continuing public importance, because it relates to the proper construction of Section 245, and especially to subdivision (a)

(8) thereof, of the Revenue Act of 1926 which provides for the deduction from gross income, in the case of life insurance companies, of "All interest paid or accrued within the taxable year on its indebtedness * * *." This pro- [fol. 5] vision is the same in all the Federal Revenue Acts since and including the Revenue Act of 1921 to and including the Revenue Act of 1932, and a determination of the question here involved will settle that question under all said Revenue Acts.

4. This case involves a new question arising under the Federal Revenue Acts which has never been decided by any other court and for this reason the decision below should be reviewed.

5. The decision below should be reviewed because it involves an important question of Federal income tax law which has not been, but should be, settled by this Court.

6. The Regulations of the Bureau of Internal Revenue provide, in the case of life insurance companies, that only interest actually withdrawn or surrendered during the year may be deducted from gross income in computing net income, which seems to be in conflict with the provisions of the Revenue Act of 1926.

7. The Court of Appeals of the District of Columbia, in Hadley vs. Commissioner of Internal Revenue (36 Fed. (2d) 543) held that profits credited to stockholders of a corporation and unqualifiedly subject to their demand are constructively received when so credited and constitute taxable income to such stockholders for the year such credit is made, regardless of whether the tax return is made on a cash or accrued basis. The Circuit Court of Appeals for the Sixth Circuit, in Commissioner of Internal Revenue vs. Bingham (35 Fed. (2d) 503) held that dividends actually received in 1923 by a stockholder whose books are kept on a cash receipts and disbursements basis are nevertheless required to be included in gross income in 1922 when they [fol. 6] were declared and unqualifiedly subject to his demand. The same principle is affirmed by the Circuit Court of Appeals for the Eighth Circuit, in Charleston & Western Carolina Railroad Company vs. Burnett (No. 5074, decided May 5, 1931; not yet reported), and by the Circuit Court of Appeals for the Seventh Circuit in Chicago, Rock Island

& Pacific Railroad Company vs. Commissioner (47 Fed. (2d) 990). These decisions seem to be in conflict with the opinion of the Court below in that the Court below, upon an important question of general law, failed to recognize and apply the distinction between an accrual in the usual case and an accrual under conditions equivalent to receipt or payment, in its construction of the Federal Revenue Act here involved.

Wherefore, your petitioner respectfully prays that a writ of certiorari be issued out of and under the seal of this Honorable Court, directed to the Court of Claims, commanding that Court to certify and to send to this Court for its review and determination, on a day certain to be therein named, a full and complete transcript of the record and all proceedings, but omitting the evidence, in the case numbered and entitled on its Docket No. K-323, The Massachusetts Mutual Life Insurance Company (A Corporation) vs. The United States, and that the said judgment of the Court of Claims may be reversed by this Honorable Court and that your petitioner may have such other and further relief in the premises as to this Honorable Court may seem meet and just; and your petitioner will ever pray.

The Massachusetts Mutual Life Insurance Company, by A. R. Serven, Guy Patten, Counsel for Petitioner.

[fols. a & 1] COURT OF CLAIMS OF THE UNITED STATES

No. K-323

THE MASSACHUSETTS MUTUAL LIFE INSURANCE COMPANY, a Corporation,

vs.

THE UNITED STATES

I. HISTORY OF PROCEEDINGS

On July 22, 1929, the plaintiff filed its original petition.

On August 31, 1929, the defendant filed a general traverse to said petition.

On January 18, 1930, by leave of court, the plaintiff filed its amended petition.

Said amended petition is as follows:

II. Amended Petition—Filed January 18, 1930

To the Honorable the Court of Claims:

The plaintiff in the above-entitled cause respectfully represents to the Court:

I

Plaintiff is a corporation, duly organized and existing under the laws of the Commonwealth of Massachusetts, having its principal office at Springfield, in said Commonwealth, and is now and has been continously engaged for many years in the business of making and selling various forms of life insurance on the mutual level premium plan in Massachusetts and other States of the United States.

II

Plaintiff has continuously complied with all the laws of the various States in which it transacts business and with [fol. 2] the rules and regulations of the respective State insurance departments thereof, prescribing the conditions upon which it was allowed to transact its said business within said States prior to and during the year 1926 and thereafter.

III

Plaintiff, because of its transacting the business of insurance within the United States during the year 1926, became and was subject to the provisions of the Revenue Act of 1926, approved February 26, 1926 (44 Stat. L. 9) and did, in the year 1927, duly file its income tax return for the year 1926 under said Revenue Act, and the regulations of the Treasury Department then in effect, and computed its net taxable income and the tax liability thereon as so required.

IV

Thereafter, the Commissioner of Internal Revenue assessed an income tax against plaintiff for the year 1926 in the amount of $208,852.37, which plaintiff paid during the

year 1927, as follows: $52,213.09 on March 14; $52,213.09 on June 13; $52,213.09 on September 12, and $52,213.10 on December 13.

V

Thereafter, the said Commissioner demanded an additional income tax for said year in the amount of $63,776.94, which plaintiff paid under protest on March 26, 1928, together with interest thereon of $3,539.18.

VI

On or about February 27, 1928, plaintiff filed its refunding claim with the said Commissioner for the refund of $160,-[fol. 3] 878.09, or such greater amount as was legally refundable, of the tax paid by it for said year, on the ground, among others, that it was entitled to the additional deduction from gross income of $544,964.40, being the amount of interest accrued and paid during said year on dividends left by policyholders with the company to accumulate at interest and accumulations thereon, said policyholders having been given credit and notice thereof for said amount in their respective individual accounts with the company, pursuant to the terms of their policy contracts, and all of which interest so credited was subject to their demand.

VII

On July 13, 1928, plaintiff received an undated overassessment certificate and attached statements from the Commissioner of Internal Revenue, based in part upon the adjudication of plaintiff's said refunding claim, which contained, among other things, the following language:

"Your contention that you are entitled to deduct interest on dividends left with the company, $544,964.40, shown on Line 22, Page 5, of annual report, cannot be conceded from the evidence submitted. The interest deduction is limited to the amount shown on Line 18, Page 3, of your annual report."

Line 18, Page 3, of plaintiff's annual statement for 1926, shows the amount of interest paid on dividends left with the company to accumulate at interest and accumulations thereon which were surrendered during the year.

VIII

In view of the language above quoted in connection with the adjudication of said refunding claim, plaintiff on or about October 4, 1928, filed an additional claim with said Commissioner for the refund of $68,120.55, or such greater amount as was legally refundable for said year, solely on [fol. 4] the ground that it was entitled to the additional deduction from gross income of $544,964.40, on account of interest accrued and paid during said year on dividends left by policyholders with the company to accumulate at interest and accumulations thereon, said policyholders having been given credit and notice thereof for said amount in their respective individual accounts with the company, pursuant to the terms of their policy contracts, and all of which interest so credited was subject to their demand. Plaintiff has not been advised of any adjudication of this refunding claim by said Commissioner, nor has it been advised of any credit or refund on account of said claim.

IX

Under Section 245 (a) (8) of the 1926 Revenue Act, plaintiff was entitled to deduct from its gross income in computing its income tax liability for the year 1926—

"All interest paid or accrued within the taxable year on its indebtedness * * *."

X

The Commissioner of Internal Revenue failed and refused to include in his computation of the deductions to which plaintiff was entitled under said Section 245 (a) (8) the item of $544,964.40, on account of interest accrued and paid by credits to policyholders in their respective individual accounts with the company during the year 1926, on dividends left with the company to accumulate at interest and accumulations thereon, pursuant to the terms of their policy contracts, and thereby deprived plaintiff of the benefit of this deduction for said year. This failure and refusal of said Commissioner to deduct the said $544,964.40 from plaintiff's gross income in the computation of its income tax liability illegally and erroneously increased the amount

of tax paid by plaintiff for said year 1926 by $68,120.55, [fol. 5] which plaintiff now asks be refunded to it, together with the $3,539.18 which the said Commissioner required plaintiff to pay as accrued interest on its additional tax of $63,776.94, as stated in Section V hereof.

XI

Plaintiff further avers that it is and has been the owner of the claim hereinbefore set forth continuously from its inception and has never sold or assigned the same or any part thereof or interest therein; that plaintiff is justly entitled to the amounts herein claimed from the United States, after allowing all just credits and offsets; that plaintiff is a citizen of the United States, and has at all times borne true allegiance to the Government of the United States and has not in any way voluntarily aided, abetted, or given encouragement to rebellion against the said Government, or aided or abetted or given encouragement to its enemies, and plaintiff believes that the facts stated herein are true.

XII

Plaintiff therefore prays judgment against the defendant for the sum of $71,659.73, with interest thereon, as provided by law.

A. R. Serven, Attorney for Plaintiff.

Duly sworn to by A. R. Serven. Jurat omitted in printing.

[fol. 6] III. General Traverse—Filed Feb. 27, 1930

And now comes the Attorney General, on behalf of the United States, and answering the amended petition of the plaintiff herein, denies each and every allegation therein contained; and asks judgment that the amended petition be dismissed.

Charles P. Sisson, Assistant Attorney General.
C. F. K.

IV. Argument and Submission of Case

On February 10, 1932, this case was argued and submitted on merits by Mr. Guy Patten, for the plaintiff, and by Mr. Assistant Attorney General Charles B. Rugg, for defendant.

[fol. 7] V. **Special Findings of Fact, Conclusion of Law, and Opinion of the Court by Littleton, J.**—Filed May 31, 1932

Mr. Guy Patten for the plaintiff.

Mr. A. R. Serven and Mr. John W. Smith were on the brief.

Mr. Assistant Attorney General Charles B. Rugg for the defendant.

Mr. Lisle A. Smith and Mr. Edward H. Horton were on the brief.

This suit was instituted to recover $71,659.73, with interest, income tax alleged to have been illegally collected for 1926, on the ground that the defendant erroneously refused to allow plaintiff a deduction under section 245 (a) (8) of the revenue act of 1926 of $544,964.40, interest accrued and credited to its policyholders on dividends declared and credited to said policyholders and left with the company at interest. The interest in question was duly credited to the policyholders during 1926 and was subject to their demand during that year.

The defendant held that the plaintiff, being a life insurance company and therefore required to compute its income and deductions on the basis of actual receipts and disbursements, was entitled to deduct, in 1926, only $248,405,97, representing the interest on dividends and accumulation thereon credited and set apart to the policyholders during 1926 and prior years, and actually withdrawn by the policyholders or surrendered to the plaintiff to be applied in reduction of premiums or used to purchase participating paid-up additions to the policies. Inasmuch as the commissioner allowed a deduction for 1926 of $248,405.97 on account of interest actually withdrawn or surrendered in 1926, the plaintiff sets forth in its brief that while the basis on which this amount was allowed as a deduction was

different from the basis on which it claims that interest on $544,964.40 was constructively paid during 1926, the amount for which judgment should be entered should be determined by deducting from gross income for 1926 the amount of $296,558.43 in excess of that allowed by the commissioner, the last-mentioned amount being the difference between the total interest credited and set apart to the policyholders during 1926 and claimed as a deduction, and the amount allowed as a deduction by the commissioner. On this basis the overpayment for 1926 would be $39,126,92, for which the plaintiff asks judgment with interest.

[fol. 8] SPECIAL FINDINGS OF FACT

1. Plaintiff, a Massachusetts corporation with principal office and place of business at Springfield, is now, and, for many years past, has been engaged in the business of making and selling various forms of life insurance on the mutual level premium plan in Massachusetts and other States of the United States.

It filed its income tax return for 1926 on Form 1120-L, designated "Life Insurance Income Tax Return," showing a tax of $208,852.37, which was paid in four installments of $52,213.09 each on March 14, June 13, and September 12, 1927, and $52,213.10 on December 13, 1927. In this return plaintiff deducted from its gross income $544,-964.40 as interest paid during 1926, which amount represented the aggregate amount of interest due policyholders on dividends and accumulated interest thereon left by them with the plaintiff to accumulate at interest and was accrued and credited to the policyholders to whom credited during the year 1926, but not actually withdrawn or surrendered by them during the year. Credit was given to each policyholder during the year in his individual account for his respective part of such interest, and a regular form notice of the amount so credited was mailed to each such policyholder prior to the close of 1926. This notice showed the amount of dividends credited, the accumulations thereon under each policy contract, and the amount of interest due and credited thereon during 1926. Interest was payable on demand to the policyholders to whom such notice was given, and the policyholder was so advised. It was the practice of the plaintiff company to accept such

notice on demand for cash payment of the amount shown therein.

2. April 9, 1921, the Treasury Department ruled that life-insurance companies were required to make their returns on the basis of actual receipts and disbursements as distinguished from an accrual basis, and such regulation was published in "Bulletin 'H,' Income Tax Rulings Peculiar to Life Insurance Companies." It provided:

"Basis of Returns.—Returns of life-insurance companies shall be made on a receipts and disbursements basis, as distinguished from an accrual basis, as being in accordance with the method of accounting regularly employed by such companies. Any life-insurance company having life and casualty departments shall report separately the incomes, disbursements, and liabilities of the two departments, of the life department upon the basis of receipts and disbursements, of the casualty department on an accrual basis."

All subsequent regulations of the Bureau of Internal Revenue promulgated by the commissioner, with the approval of the Secretary of the Treasury, provided that the income-tax returns of life-insurance companies should be made on the cash receipts and disbursements basis, and that the return, Form 1120-L, mentioned in Finding 1 hereof, which form of return was used by plaintiff for 1926, contains the instruction as to the basis upon which said return should be made, to wit, that "a return on this form shall be rendered on a cash receipts and disbursements basis in conformity with the annual statement made to the State insurance department instead of the accrual basis."

[fol. 9] 3. Plaintiff was required by the laws of Massachusetts to file, and it did file, with the State insurance commission of the Commonwealth annual statements (convention edition) for the calendar years 1925 and 1926 showing its financial condition for each year, and showing, among other things, its ledger assets, income, disbursements, and liabilities.

4. The plaintiff's annual statement, convention edition, to the insurance commission of Massachusetts for 1926 was filed with the Commissioner of Internal Revenue, which an-

nual statement contained in line 18, page 3, a statement that "Dividends $1,767,501.89 and interest $248,405.97 thereon held on deposit, surrendered during the year $2,015,907.86"; and on line 22, page 5, the statement that "Dividends left with the company to accumulate at interest, and accrued interest thereon, including $544,964.40, interest credited during the year and payable on demand $14,000,669.68." The item of $544,964.40 shown on line 22, page 5, of said annual statement was the amount of interest accrued and credited to plaintiff's policy holders during 1926, but not actually withdrawn or surrendered to the company by them during the year. The item of $248,405.97 shown on line 18, page 3, of said annual statement was the total amount of interest accrued and credited to the policyholders and actually withdrawn in cash or surrendered by said policyholders during the year 1926, irrespective of the year of origin. The major portion of this item originated in prior years. The record does not disclose the amount included therein which accrued on dividends and accumulations thereon for the year 1926.

5. The commissioner audited the return for 1926 and disallowed the deduction claimed by plaintiff for interest, and, instead, allowed a deduction of the amount of interest on dividends and accumulations held on deposit and withdrawn or surrendered during the year 1926 in the amount shown at line 18, page 3, of the annual report, $248,405.97. The commissioner determined an additional tax of $63,776.94, which was timely assessed and was paid by plaintiff under protest March 26, 1928, together with interest thereon of $3,539.18.

6. February 27, 1928, plaintiff duly filed a claim for refund for 1926 of $160,878.09, or such greater amount as should be legally refundable, upon the ground, among others, that it was entitled to a deduction from gross income of $544,964.40, interest accrued and credited to its policyholders during the year 1926 on dividends left by them to accumulate at interest, which deduction plaintiff had claimed on its return but which the commissioner had disallowed.

7. July 13, 1928, plaintiff received from the commissioner his undated overassessment certificate and schedules at-

tached thereto auditing the return for 1926 on the cash receipts and disbursements basis of accounting. This audit disclosed that in adjudicating the refund claim the commissioner disallowed the aforementioned item of $544,964.40 as a deduction from gross income and instead allowed an item of $248,405.97 as a deduction from gross income for the year, representing interest on dividends left by policyholders with the company to accumulate at interest, which [fol. 10] was actually withdrawn or surrendered by the policyholders during said year. The pertinent provisions of the certificate of overassessment are as follows:

"Net income reported on return		$1,670,818.96
Add:		
1. Interest on dividends left with company, item 22, page 5 of annual report		544,964.40
2. 4% of mean of reserve funds overstated		270,190.80
3. Taxes, item 10 of return, restored		33,882.42
4. Other real estate expense, item 11 of return, restored		40,770.33
Total		2,560,626.91
Deduct:		
5. Interest on dividends held on deposit and surrendered during the year, item 18, page 3 of annual report	$248,405.97	
6. Taxes and other expenses deductible	47,179.43	
7. Rent on home office building	89,100.00	
		384,685.40
Net income adjusted		$2,175,941.51"

"Explanation of Changes

"1 and 5. Interest payable on demand, shown as an accrual on line 22, page 5 of annual report, is not an allowable deduction. Interest on dividends held on deposit and surrendered during the year, shown on page 3 of annual report, line 18, constitutes an allowable deduction. Article 685, Regulations 69.

* * * * * * *

"Your contention that you are entitled to deduct interest on dividends left with the company, $544,964.40, shown on line 22, page 5, of annual report, can not be conceded from the evidence submitted. The interest deduction is limited to the amount shown on line 18, page 3, of your annual report."

8. The policy contract used by plaintiff during 1926 contained the provisions:

"This policy will participate at the end of the first policy year, and annually thereafter, in the distribution of the surplus funds of the company. At the option of the insured, dividends will be (1) paid in cash, or (2) applied in reduction of premiums, or (3) used to purchase participating paid-up additions, or (4) held by the company to accumulate subject to withdrawal on demand. If no election is made prior to any anniversary, the dividend for that anniversary will be held by the company to accumulate.

"Paid-up additions will have a cash surrender value (full reserve) but the company may, at its option, defer the granting of such surrender value for a period not exceeding ninety days from the date of the application therefor.

"Dividend accumulations will be credited at the end of each policy year with interest at such rate, not less than three per cent, as may be determined by the directors. Outstanding dividend accumulations will be added to the cash value of the policy in the event of surrender or to the amount payable under the policy if it becomes a claim by death.

"If this policy becomes a claim by death, the dividend for the current year will be paid in cash in addition to the sum insured."

[fol. 11] 9. October 4, 1928, plaintiff timely filed a further claim for refund for 1926 of $68,120.55, or such greater amount as should be legally refundable, solely on the ground that it was entitled to deduct from gross income said item of $544,964.40, representing income accrued and credited to its policyholders during the year on dividends left with the company to accumulate at interest, and accumulations thereon. No notice has been given to the plaintiff of any action on this claim by the commissioner.

Conclusion of Law

Upon the foregoing special findings of fact, which are made a part of the judgment herein, the court decides as a conclusion of law that the plaintiff is not entitled to recover, and its petition is therefore dismissed.

Judgment is rendered against plaintiff for the cost of printing the record herein, the amount thereof to be entered by the clerk and collected by him according to law.

Opinion

Littleton, Judge, delivered the opinion of the court:

The plaintiff, a life insurance company, was required by the revenue statute and the regulations of the Treasury Department in force during 1926 to determine its income and deductions, and compute its tax on the basis of receipts and disbursements as distinguished from an accrual basis.

The question in this case is whether the plaintiff is entitled to deduct from gross income for 1926, as interest paid, the amount of such interest credited to its policyholders during the year 1926. The policyholders were notified during the year of the amount of interest so credited and that it would be paid upon demand or handled in accordance with the terms of the policy contract, upon receipt of notice of the desire of the policyholder. The policy contract, under which the plaintiff became liable for the interest so credited, provided that it was "subject to withdrawal on demand." If a policyholder did not withdraw the interest or surrender it for application by the company in reduction of premiums or to purchase participating paid-up additions, it was allowed to accumulate and interest on such accumulations was thereafter credited to the policyholders. In these circumstances the plaintiff contends that interest in the amount of $544,964.40 credited to the policyholder was constructively paid by it and was a proper and legal deduction from gross income for the year in which credited.

The defendant insists that the interest item of $544,964.40 is purely an accrued item which, under the law and the regulations, is not an allowable deduction on the cash receipts and disbursements basis of accounting, which method of accounting the plaintiff was required to and did employ; that article 51 of Treasury Regulations 69, and prior regulations under prior revenue acts provide that "Income which is credited to the account of or set apart for a taxpayer and which may be drawn upon by him at any time is subject to tax for the year during which so credited or set apart, although not then actually re- [fol. 12] duced to possession. To constitute receipt in such a case the income must be credited to the taxpayer without any substantial limitation or restriction as to the time

or manner of payment or condition upon which payment is to be made. * * * If the income is not credited, but is set apart, such income must be unqualifiedly subject to the demand of the taxpayer, * * *" applies solely to the recipients of a credit when, according to the method of accounting employed by the taxpayer making the credit, there is a payment for income tax purposes; that the regulation therefore can have no application to a credit by a taxpayer employing the cash receipts and disbursements method of accounting.

The plaintiff relies upon Corliss v. Bowers, 281 U. S. 376; Commissioner v. Bingham, 35 Fed. (2d) 503; Hadley v. Commissioner, 36 Fed. (2d) 543; Chicago, R. I. & P. Ry. Co. v. Commissioner, 47 Fed. (2d) 990; Charleston & W. C. Ry. Co. v. Burnet, 50 Fed. (2d) 342; John A. Brander, 3 B. T. A. 231; Chipley v. Commissioner, 25 B. T. A. 1103. These cases are not applicable to the question here involved. The Corliss case involved income from a revocable trust and the Bingham and Hadley cases involved the question whether dividends declared and made unqualifiedly subject to the demand of the stockholders were income in the year in which declared and set apart. When a dividend is declared and set apart to the stockholders the amount thereof is separated from the invested capital of the corporation and the provisions of the above-quoted regulation have been consistently applied. Section 201 (e) of the revenue act of 1921 specifically provided that such dividends constitute income to the stockholders. The two railroad cases involved the question whether the amounts accrued and deducted by the corporations from gross income in the years credited but not paid constituted income to the corporations in subsequent years when the credits were charged to profit and loss. The Brander and Chipley cases involved the question whether a salary credited to an officer of a corporation employing the accrual method of accounting and available for withdrawal by him, constituted income, and the rule announced in the regulation quoted was applied. It will be seen, therefore, that in the ordinary case the question of constructive receipt of income arises where the taxpayer making the credit employs the accrual method of accounting. In such cases the credit constitutes a payment for tax purposes, and it has been consistently held that the person to whom the amount is

credited and made unqualifiedly subject to his demand may not escape taxation thereon by failing to withdraw it.

Other than in the administration of estates or trusts, as to which the statute specifically provides for a deduction of credits under certain circumstances, we know of no instance, and none has been called to our attention, in which it has been held that an amount credited but not paid by a taxpayer employing the cash receipts and disbursements method of accounting constitutes income to the person to whom credited. It is not claimed that the interest credited by the plaintiff to its policyholders during 1926 was taxed as income to them in that year by the commissioner. To hold that an amount credited by a taxpayer employing a cash receipts and disbursements method of accounting constitutes a payment, and is, therefore, deductible from gross income in the year in which credited, would destroy the dis-[fol. 13] tinction between the accrual and the receipts and disbursements methods of accounting which is recognized and made controlling by the revenue statutes. United States v. Anderson, 269 U. S. 422; United States v. Mitchell, 271 U. S. 9, 12. It follows therefore that plaintiff is not entitled to a deduction of the interest credited to its policyholders during 1926 on the ground that there was a constructive payment thereof in that year.

It is also urged by the plaintiff that section 245 (a) (8) of the revenue act of 1926 authorizes a deduction by insurance companies of interest paid or accrued, within the taxable year on its indebtedness. The language of this subsection is the same as section 234 (a) (2) relating to deductions by ordinary corporations, and section 214 (a) (2) relating to deductions by individuals, and, in our opinion, the term "paid or accrued" must be construed according to the method of accounting employed as provided in section 200 (d) of the revenue act of 1926. We think that in the enactment of subdivision (8) of section 245 (a), of the revenue act of 1926, Congress did not intend to make an exception in favor of insurance companies to the recognized rule that deductions from gross income should be determined in accordance with the method of accounting employed.

The petition is dismissed. It is so ordered.

Whaley, Judge; Williams, Judge; Green, Judge, and Booth, Chief Justice, concur.

VI. JUDGMENT

At a Court of Claims held in the City of Washington on the 31st day of May, A. D., 1932, judgment was ordered to be entered as follows:

Upon the special findings of fact, which are made a part of the judgment herein, the court decides as a conclusion of law that the plaintiff is not entitled to recover, and its petition is therefore dismissed.

[fol. 14] Clerk's certificate to foregoing transcript omitted in printing.

SUPREME COURT OF THE UNITED STATES

ORDER ALLOWING CERTIORARI—Filed November 7, 1932

The petition herein for a writ of certiorari to the Court of Claims is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

FILE COPY

SEP 28 1932

Supreme Court of the United States

October Term, 1932.

No. 322.

THE MASSACHUSETTS MUTUAL LIFE INSURANCE COMPANY (A Corporation),
Petitioner,

v.

THE UNITED STATES,
Respondent.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

A. R. SERVEN,
GUY PATTEN,
Counsel for Petitioner.

PRESS OF THE SUDWARTH CO., WASHINGTON

Subject Index

		Page
Brief in support of petition for writ of certiorari		1
I.	The opinion of the court below	1
II.	Jurisdiction	1
III.	Statement of the case	2
IV.	Specification of errors	3
V.	Argument	4
	Summary of Argument	5
	Point A. The statute is clear and unambiguous	6
	Point B. Conflict with prior Federal Court decisions	12
	Point C. Treasury Regulations in conflict with Federal statute	15
	Point D. A new question of substance which has not been, but should be, settled by this Court	16
Conclusion		17

Table of Cases Cited

Barstow v. Bowers, 2d C. C. A., 15 Fed. (2d) 75, 78	10
Bernier v. Bernier, 47 U. S. 242; 37 L. ed. 152	7
Brown v. Deschesne, 19 How. 183, 15 L. ed. 595	8
Charleston & Western R. R. Co. v. Burnett, No. 5074, decided by Court of Appeals, 8th District, May 5, 1931, not yet reported	14
Chicago, Rock Island & Pac. R. R. Co. v. Commissioner, 47 Fed. (2d) 990	14
Com. Int. Rev. v. Bingham, 35 Fed. (2d) 503	14
Early v. Doe, 16 How. 610; 14 L. ed. 1079	16
Fields v. United States, 205 U. S. 292; 51 L. ed. 807	2
Hadley v. Com. of Int. Rev., 36 Fed. (2d) 543	12
Hamilton Brown Shoe Co. v. Wolf Bros., 240 U. S. 251; 60 L. ed. 629	2
Lawrence v. Allen, 7 How. 785; 12 L. ed. 914	7
Magnum Import Company v. Coty, 262 U. S. 159; 67 L. ed. 922	2
Mason v. United States, 260 U. S. 545; 67 L. ed. 396	7

Montclair Twp. v. Ramsdell, 107 U. S. 147; 27 L. ed. 431 16
Peck v. Jenness, 7 How. 612; 12 L. ed. 841 7
United States v. Anderson, 269 U. S. 422 10
United States v. Gooding, 12 Wheat. 460; 6 L. ed. 693 16
United States v. Mitchell, 271 U. S. 9 10
United States v. Landram, 118 U. S. 81; 30 L. ed. 58 6
United States v. Voisdore, 8 How. 113; 12 L. ed. 1009 8
Washington Market Co. v. Hoffman, 101 U. S. 112; 25 L. ed. 782 8
Wilmot v. Mudge, 103 U. S. 217; 26 L. ed. 536 16

APPENDIX

The Statutes

Revenue Act 1926, 44 Stat. L. 10 18
Sec. 200 (d), General provisions 18
212, Net income of individual defined 18
213, Gross income of individuals defined 19
214, Deductions allowed individuals 20
232, Net income of corporations defined 21
233, Gross income of corporations defined 21
234, Deductions allowed corporations 21
242, Tax on life insurance companies 23
243, Rate of tax on life insurance companies 23
244, Gross income of life insurance companies defined 24
245, Net income of life insurance companies defined 24

The Regulations

Regulations No. 69, Article 685 (3) 26

Supreme Court of the United States

October Term, 1932.

No. 322.

THE MASSACHUSETTS MUTUAL LIFE INSURANCE COMPANY (A Corporation),
Petitioner,

v.

THE UNITED STATES,
Respondent.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

I.
OPINION OF THE COURT BELOW.

The opinion of the court below has not yet been reported, but was rendered by the Court of Claims on May 31, 1932, and appears at page 16 of the Record herein.

II.
JURISDICTION.

1. Jurisdiction is invoked under Section 3 (b) of the Act approved February 13, 1925 (43 Stat. L. 939).

2. The judgment of the Court of Claims dismissing the petition was entered on May 31, 1932 (R. 19).

The petition for certiorari was filed on August 26, 1932.

3. Petitioner claimed in the court below that it was entitled to recover against the United States for internal revenue taxes overpaid by it for the year 1926, due to the disallowance by the Commissioner of Internal Revenue of interest accrued and credited to its policyholders during said year, subject to withdrawal on demand, to which it was entitled as a deduction from gross income under the provisions of Section 245 (a) (8) of the Revenue Act of 1926 (44 Stat. L. 47, 48) (R. 7, Am'd. Pet. VI, R. 12-14, Find. 4, 5, 6, 7). Its petition was dismissed by the judgment of the court below.

4. Attention is invited to the following cases, under which it is believed the writ prayed for should be granted:

Fields v. United States (205 U. S. 292; 51 L. Ed. 807).
Hamilton Brown Shoe Co. v. Wolf Bros. Co. (240 U. S. 251; 60 L. ed. 629).
Magnum Import Company v. Coty (262 U. S. 159; 67 L. ed. 922).

III.

STATEMENT OF THE CASE.

A full statement of all that is material to the case has been given under heading "A" in the petition for the writ (R. 1) and, in the interest of brevity, the statement will not be repeated here.

There is no question here in regard to the deduction of interest when actually withdrawn or

surrendered by the policyholders, as the petitioner is not claiming it is entitled to deduct interest when accrued and credited subject to withdrawal on demand, and again when actually withdrawn. (R. 10, 11).

IV.

SPECIFICATION OF ERRORS.

1. The Court of Claims erred in holding that interest accrued and unconditionally credited to policyholders during the tax year subject to withdrawal on demand, in compliance with the terms of the policy contracts, was not deductible from gross income for such year under the provisions of the tax act unless it was actually withdrawn by the policyholder during such tax year.

2. The Court of Claims erred in holding that petitioner's right under the tax act to the deduction of the interest involved here was dependent upon the method of accounting employed.

3. The Court of Claims erred in holding that in the enactment of subdivision (8) of Section 245 (a) of the Revenue Act of 1926 Congress did not intend to make an exception, in the case of life insurance companies, to the general rule that deductions from gross income should be determined in accordance with the method of accounting employed.

4. The Court of Claims erred in holding that to allow the deduction of interest accrued and credited to policyholders during the tax year subject to withdrawal on demand, in the case of life

insurance companies taxable under the special provisions of the Revenue Act relating to them, would destroy the distinction between the paid and the accrued methods of accounting, or that such distinction is applicable to this case.

5. The Court of Claims erred in holding, either directly or by analogy, that subdivision (8) of Section 245 (a) of the Revenue Act of 1926 is affected by the provisions of Section 200 (d) of said Act.

6. The Court of Claims erred in its failure to distinguish between purely an accrued item and an item which, immediately upon accrual, is set aside to the policyholder subject to withdrawal on demand.

V.

ARGUMENT.

The interest involved arose under the outstanding policy contracts of the company (R. 11, Find. 1) which provided that dividends left with the company will draw interest, that such interest will be set aside or credited to the policyholder each year as it accrues, and is subject to withdrawal on demand (R. 14, Find. 8). In the conduct of its business the company each year meets its said obligations in the manner provided, notifies each such policyholder in writing of the amount of such interest credited to him and in practice accepts such notices on demand for cash payment of the amount shown therein. (R. 11, Find. 1).

Statutes and Regulations.

The pertinent provisions of the Revenue Act

of 1926 and the Regulations of the Treasury Department thereunder are set forth in full in the Appendix hereto (P. 18). The following appear therein:

Section 245 (44 Stat. L. 48) (a) in the case of a life insurance company the term "net income" means the gross income less—

x x x x x x

(8) All interest paid or accrued within the taxable year on its indebtedness, * * *. (P. 25).

The Regulations.

Regulations 69, pertaining to the Revenue Act of 1926, provides by Article 685, subdivision (3) that—

> "The deduction allowed by Section 245 (a) (8) for interest on indebtedness is the same as that allowed other corporations by Section 234 (a) (2) (See Articles 561 and 121) but this deduction includes item 18 of the disbursement page of the annual statement of life companies to the extent that interest on dividends held on deposit and surrendered during the taxable year is included therein. Dividends left with the company to accumulate at interest are a debt and not a reserve liability." (P. 26).

Summary of the Argument.

A. The statute involved is clear and unambiguous, and the decision below is in conflict therewith.

B. The decision below is contrary to and in conflict with prior Federal court decisions upon an important general question of law applicable to this case.

C. The Regulations of the Bureau of Internal Revenue are in conflict with the Federal statute involved.

D. The question involves the construction of a Federal statute relating to a very large class of income tax payers, which has not been, but should be, settled by this court.

A.

THE STATUTE INVOLVED IS CLEAR AND UNAMBIGUOUS.

Succinctly stated, petitioner contends it is entitled to the deduction here claimed because the statute says so. Sections 242 to 245, inclusive, relate solely to life insurance companies and constitute a special statute for determining the income tax liability of this class of tax payers. These sections of the statute provide (P. 24-25) that "gross income" means the gross amount received during the taxable year from interest, dividends and rents, and that "net income" means gross income less—(certain deductions not involving payment), exempt interest received, dividends received, investment expenses paid, taxes and other expenses paid during the taxable year, and interest paid or accrued within the taxable year. The words "paid or accrued," as they appear in the provision for the deduction of interest, must be construed in connection with the other provisions so as to give an harmonious effect to the whole plan of Congress for determining the taxable net income of this class of tax payers. (*United States v. Landram*, 118 U. S. 81; 30 L. ed. 58; *Mason v.*

United States, 260 U. S. 545; 67 L. ed. 396; *Lawrence v. Allen*, 7 How. 785; 12 L. ed. 914; *Peck v. Jenness*, 7 How. 612; 12 L. ed. 841; *Bernier v. Bernier*, 47 U. S. 242; 37 L. ed. 152).

The foregoing plan of dealing with life insurance companies was first adopted by Congress in the Revenue Act of 1921 (42 Stat. L. 227), approved November 23, 1921. That Act likewise contained the same difference of expression with reference to the provision for the deuctions of interest, and that of other deductions, as appears in all the later Revenue Acts. Prior to the passage of the Revenue Act of 1921, the Treasury Department, on April 9, 1921, had ruled that life insurance companies were required to make their returns on the cash receipts and disbursements basis as distinguished from an accrual basis, as being in accordance with the method of accounting regularly employed by such companies, and such Regulation was duly published (R. 12, Find. 2). That Congress was familiar with the conditions of the business and said ruling of the Treasury Department is evidenced by the provisions of the Revenue Act of 1921, and like provisions in all subsequent Acts. The definite and specific terms of the legislation which followed emphasize the significance of the provision for the deduction of interest "paid or accrued." When it is considered that the business of life insurance companies is that of selling life insurance evidenced by written contracts, then the findings of the Court below covering the terms of those con-

tracts, the practice and method employed in transacting such business with policyholders, likewise familiar to it, explains why Congress provided for the deduction of interest in different terms than those relating to other items of receipt and disbursement. It was conforming its legislation to the conditions of the business. All interest as it accrued was in practice, in fact and pursuant to contract, credited under conditions equivalent to payment. It was set apart to policyholders subject to their demand. Its deduction from gross income in connection with the other provisions reflects the correct net result of the operations for the taxable year without involving transactions for any prior or subsequent year. In view of the whole plan it is logical that Congress should provide for the deduction of all interest accrued within the taxable year, whether actually paid or not. We believe this construction gives due weight, as any construction must if possible, to all the words of the statute, and is in harmony and consistent with the other provisions and the plan as a whole for determining the taxable net income of life insurance companies. (*Washington Market Co. v. Hoffman*, 101 U. S. 112; 25 L. ed. 782; *Brown v. Duchesne*, 19 How. 183; 15 L. ed. 595; *United States v. Voisdore*, 8 How. 113; 12 L. ed. 1009).

Right to Deduction Does Not Depend on Accounting Method Employed.

As above noted, the provisions of Sections 242 to 245, inclusive, of the Revenue Act are definite

and inflexible. Under those provisions there is no basis upon which a life insurance company can be taxed except that detailed in the statute. The method of accounting regularly employed by such companies, known to Congress, would seem in itself to explain why these provisions relating to life insurance companies are definitely fixed, while the provisions (P. 18-23) relating to individuals and other corporations, whose methods of accounting may widely differ, are expressly dependent upon the method employed. These fixed provisions relating solely to life insurance companies are not subject to any change in accounting methods which such a company might adopt, hence are not dependent upon the method employed. By the same measure, the question of whether the allowance of interest accrued and credited subject to demand under Section 245 (a) (8) would destroy the distinction between the paid and the accrued methods of accounting, not only becomes irrelevant, but Congress evidently considered it would not. This provision for the deduction of "All interest paid or accrued" is not so much an exception, in the case of life insurance companies, to the general rule that deductions from gross income should be determined in accordance with the method of accounting employed, as it is a provision based by Congress upon the known conditions of the business. The word "accrued" cannot be read out of the statute. If it be read as depending upon the method of accounting employed it can never have any meaning or operative effect under any cir-

cumstances, which amounts to the same thing, because the statute is definite and inflexible that all items of receipt and all other items of deduction involving payment, shall be returned on the cash basis. It is the purpose of taxing statutes to require returns that clearly reflect correct taxable income. It is a reasonable construction of the law that the same method be applied to both sides of the account. (*United States v. John J. Mitchell*, et al., 271 U. S. 9, at page 12; *United States v. Anderson*, 269 U. S. 422; *W. S. Barstow & Co. v. Bowers*, 2d C. C. A., 15 Fed. (2d) 75, 78).

But the above cases which laid down these principles were dealing with statutes and regulations under which the taxpayer might make his return on either the "paid" or "accrued" basis, depending upon the method of accounting employed by him. No such condition is possible under the provisions relating to life insurance companies involved here. But the deduction of all interest accrued and credited to policyholders during the taxable year does meet the rule of consistency and reflects the true net income of the company for such year, because such interest is actually set aside to the policyholders and thereafter is subject to their demands (R. 11, Find. 1) and not that of petitioner.

In the Report of the Committee on Ways and Means on H. R. 8245 (Revenue Bill of 1921), Report No. 350, p. 14 (Mr. Fordney), 67th Congress, 1st Session, it was said:

Life Insurance Companies.

"Sections 242-246: The provisions of the present law applicable to life insurance companies are imperfect and productive of constant litigation. Moreover, the taxes paid by life insurance companies under the income tax are inadequate. It is accordingly proposed in lieu of all other taxes to tax life insurance companies on the basis of their investment income from interest, dividends, and rents, with suitable deduction for expenses fairly chargeable against such investment income. x x x"

The deduction of interest on the basis here claimed being necessary to correctly reflect the true net income of a life insurance company, Congress so provided.

It is submitted that the deduction of interest set aside to policyholders subject to their demand is essential in order to determine the current year's income of the company and to avoid the taxation to it of a portion of its gross investment income which is not actually realized as income within the year.

Section 200 (d) Not Applicable.

Section 200 (d) (Appen. P. 18), by its own terms, expressly limits its provisions to those taxpayers whose "Net income is computed under Section 212 or 232."

Section 212 (Appen. P. 18), deals with individuals and Section 232 (Appen. P. 21) deals with corporations other than insurance companies. Both these classes of taxpayers are allowed to

make their returns on either the "paid" or "accrued" basis. The statute allows them to deduct (alike in Sections 214 and 234) "all x x x expenses paid or incurred during the taxable year," "all interest paid or accrued within the taxable year," "taxes paid or accrued within the taxable year." Congress therefore provided by Section 200 (d) that "The terms x x x 'paid or accrued'" shall be construed according to the method of accounting upon the basis of which the net income is computed under Section 212 or 232. Section 200 (d), so far as the provisions relating to life insurance companies are concerned, has no subject matter upon which to operate. Hence Congress, acting advisedly, limited the operation of Section 200 (d) to Sections 212 and 232.

B.

CONFLICT WITH PRIOR FEDERAL COURT DECISIONS.

In the background of this case is a general question of law which is important in determining the sense in which Congress used the word "accrued" in the interest deduction involved when considered in its relation to the other provisions of the statute relating to life insurance companies, i. e., the distinction between an accrual in the usual sense of the term, and to an accrual credited in such manner as to constitute constructive payment.

In *Hadley v. Commissioner of Internal Revenue* (36 Fed. (2d) 543), the Court of Appeals of the District of Columbia, in affirming a decision of the

United States Board of Tax Appeals (6 B. T. A. 1031), held that profits credited to stockholders of a corporation and unqualifiedly subject to their demand are constructively received when credited and constitute taxable dividends to the stockholders. In that case the court draws the exact distinction contended for by plaintiff in the case at bar when it says:

> "It does not clearly appear whether the taxpayer rendered his return on a cash or accrual basis, but we think this is not material, since the mere credit of his account with the earnings constituted an accrual. (*United States v. Anderson*, 269 U. S. 422 (T. D. 3839, C. B. V-I, 179). However, according to the practice of the Department, the amounts were constructively received when credited. Under article 4, paragraph 51, Treasury Regulations 33, article 53, it is provided as follows:
>
> 'Income which is credited to the account of or set apart for a taxpayer and which may be drawn upon by him at any time is subject to tax for the year during which so credited or set apart, although not then actually reduced to possession. To constitute receipt in such a case the income must be credited to the taxpayer without any substantial limitation or restriction as to the time or manner of payment or condition upon which payment is to be made. A book entry, if made, should indicate an absolute transfer from one account to another. If the income is not credited, but is set apart, such income must be un-

qualifiedly subject to the demand of the taxpayer.'

x x x This distinction between receipt and accrual must be kept in mind. Income may accrue to the taxpayer and yet not be subject to his demand or capable of being drawn on or against by him.

"Clearly, under this rule, the earnings set aside in the present case must be construed as a receipt instead of an accrual, since the share of the earnings belonging to the appellant was not only placed to his credit on the books of the corporation, but was brought unqualifiedly subject to his demand. It was money available for his use as much as if it has been placed in his bank account subject to check."

In *Commissioner of Internal Revenue v. Bingham* (35 Fed. (2) 503), the Circuit Court of Appeals for the Sixth Circuit held that dividends actually received in 1923 by a stockholder whose books are kept on a cash receipts and disbursements basis are nevertheless required to be included in gross income in 1922, when they were declared and unqualifiedly subject to his demand.

The same principle is affirmed in *Charleston & Western Carolina Railroad Company v. Burnett* (No. 5074, decided by the Court of Appeals, District Eight, May 5, 1931, not yet reported), and *Chicago, Rock Island & Pacific Railroad Company v. Commissioner* (Circuit Court of Appeals, Seventh Circuit, 47 Fed. (2d) 990).

It is respectfully submitted that the decision of the court below, in its application of this general

question of law is in conflict with the foregoing decisions.

C.

REGULATIONS IN CONFLICT WITH FEDERAL STATUTES.

Treasury Regulations 69, Article 685, (Appen. P. 26) provides:

> "(3) The deduction allowed by Section 245 (a) (8) for interest on indebtedness is the same as that allowed other corporations by Section 234 (a) (2) (See articles 561 and 121) but this deduction includes item 18 of the disbursement page of the annual statement of life companies to the extent that interest on dividends held on deposit and surrendered during the taxable year is included therein. Dividends left with the company to accumulate at interest are a debt and not a reserve liability."

Article 561 provides:

> "Art. 561. Allowable Deductions—In general the deductions from gross income allowed corporations are the same as allowed individuals x x x."

Article 121 provides:

> "Art. 121. Interest—Interest paid or accrued within the year on indebtedness may be deducted from gross income, x x x."

Obviously Article 685 when read in connection with the references therein contained is intended to provide that the deduction allowed life insurance companies by Section 245 (a) (8) for interest on indebtedness is dependent upon the method

of accounting employed, with the further specific limitation that interest on dividends held on deposit may not be deducted unless actually withdrawn or surrendered by the policyholder during the taxable year. This question has been discussed under Point A herein and will not be repeated here. Upon the reasoning there adduced, it is respectfully submitted that the provisions of the Revenue Act (Sections 242 to 245, inclusive), are not susceptible to the restricted interpretation placed thereon in the foregoing Treasury Regulations, unless we indulge in the liberty of treating the word "accrued," in the provision for the deduction of interest on indebtedness, as superfluous, void or insignificent. Such treatment would violate the well established rule that effect must be given to all the words of a statute, when this is possible without conflict. (*United States v. Gooding*, 12 Wheat. 460; 6 L. ed. 693; *Montclair Twp. v. Ramsdell*, 107 U. S. 147; 27 L. ed. 431; *Early v. Doe, ex dem. Homans*, 16 How. 610; 14 L. ed. 1079; *Wilmot v. Mudge*, 103 U. S. 217; 26 L. ed. 536).

D.

A NEW AND SUBSTANTIAL QUESTION.

From all of the foregoing the petitioner respectfully submits that the question here is one of substance relating to the construction of a statute of the United States which has not been, but should be, settled by this Court. The Revenue Act of 1921 made a radical change in the basis of computing the net income of life insurance companies.

The plan then adopted by Congress has been followed in all subsequent Revenue Acts, including the Revenue Act of 1932. The provision for the deduction of interest on indebtedness, involved here, is alike in all said Acts. The construction of this provision has never been settled by this Court. The determination of the question here will settle it under all the Revenue Acts since and including the Revenue Act of 1921. It is of broad and general importance, as it affects a large class of income tax payers.

CONCLUSION.

It is, therefore, respectfully submitted that this case is one calling for the exercise by this Court of its supervisory powers, in order that a substantial question of great importance relating to the proper construction of a statute of the United States and affecting a large class of income tax payers may be settled by this Court, and that to such an end a writ of certiorari should be granted and this Court should review the decision of the Court of Claims and finally reverse it.

Respectfully submitted,

A. R. SERVEN,
GUY PATTEN,
Counsel for Petitioner.

APPENDIX.

The Statutes.

The pertinent provisions of the Revenue Act of 1926 read as follows:

TITLE II—INCOME TAX.

PART I.—GENERAL PROVISIONS.

Definitions.

Sec. 200 (44 Stat. 10). When used in this title—

x x x x x x

(d) The terms "paid or incurred" and "paid or accrued" shall be construed according to the method of accounting upon the basis of which the net income is computed under section 212 or 232. The deductions and credits provided for in this title shall be taken for the taxable year in which "paid or accrued," or "paid or incurred," dependent upon the method of accounting upon the basis of which the net income is computed under section 212 or 232, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period.

Net Income of Individuals Defined.

Sec. 212. (44 Stat. 23). (a) In the case of an individual the term "net income" means the gross income as defined in section 213, less the deductions allowed by sections 214 and 206.

(b) The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the

method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year as defined in section 200 or if the taxpayer has no annual accounting period or does not keep books, the net income shall be computed on the basis of the calendar year.

Gross Income Defined.

Sec. 213 (44 Stat. 23). For the purposes of this title, except as otherwise provided in section 233—

(a) The term "gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including in the case of the President of the United States, the judges of the Supreme and inferior courts of the United States, and all other officers and employees, whether elected or appointed, of the United States, Alaska, Hawaii, or any political subdivision thereof, or the District of Columbia, the compensation received as such), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or

gains or profits and income derived from any source whatever. The amount of all such items shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under subdivision (b) of section 212, any such amounts are to be properly accounted for as of a different period.

Deductions Allowed Individuals.

Sec. 214. (44 Stat. 26). (a) In computing net income there shall be allowed as deductions:

(1) All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries x x x.

(2) All interest paid or accrued within the taxable year on indebtedness, x x x.

(3) Taxes paid or accrued within the taxable year x x x.

(4) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in trade or business.

(5) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit, though not connected with the trade or business; x x x.

(6) Losses sustained during the taxable year of property not connected with the trade or business (but in the case of a non-resident alien individual only property within the United States) if arising from fires, storms, shipwreck, or other casualty, or from theft,

and if not compensated for by insurance or otherwise. x x x.

(7) Debts ascertained to be worthless and charged off within the taxable year x x x.

(8) A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence. x x x.

(9) x x x x
(10) x x x x
(11) x x x x

Net Income of Corporations Defined.

Sec. 232 (44 Stat. 41). In the case of a corporation subject to the tax imposed by section 230 the term "net income" means the gross income as defined in section 233 less the deductions allowed by sections 234 and 206, and the net income shall be computed on the same basis as is provided in subdivisions (b) and (d) of section 212 or in section 226. In the case of a foreign corporation or of a corporation entitled to the benefits of section 262 the computation shall also be made in the manner provided in section 217.

Gross Income of Corporations Defined.

Sec. 233 (44 Stat. 41). (a) In the case of a corporation subject to the tax imposed by section 230 the term "gross income" means the gross income as defined in sections 213 and 217, except that mutual marine insurance companies shall include in gross income the gross premiums collected and received by them less amounts paid for reinsurance.

Deductions Allowed Corporations.

Sec. 234. (44 Stat. 41). (a) In comput-

ing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:

(1) All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, x x x.

(2) All interest paid or accrued within the taxable year on its indebtedness, x x x.

(3) Taxes paid or accrued within the taxable year x x x.

(4) Losses sustained during the taxable year and not compensated for by insurance or otherwise. x x x.

(5) Debts ascertained to be worthless and charged off within the taxable year x x x.

(6) The amount received as dividends x x x.

(7) A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence.

(8) In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; x x x.

(9) In the case of insurance companies (other than life insurance companies), in addition to the above (unless otherwise allowed): (A) The net addition required by law to be made within the taxable year to reserve funds x x x.

(10) In the case of mutual marine insurance companies, there shall be allowed, in addition to the deductions allowed in paragraphs (1) to (9), inclusive, unless otherwise allowed, amounts repaid to policyholders

on account of premiums previously paid by them, and interest paid upon such amounts between the ascertainment and the payment thereof;

(11) In the case of mutual insurance companies (including interinsurers and reciprocal underwriters, but not including mutual life or mutual marine insurance companies) requiring their members to make premium deposits to provide for losses and expenses, there shall be allowed, in addition to the deductions allowed in paragraphs (1) to (9), inclusive, unless otherwise allowed, the amount of premium deposits returned to their policyholders and the amount of premium deposits retained for the payment of losses, expenses, and reinsurance reserves.

x x x.

Tax on Insurance Companies.

Sec. 242. (44 Stat. 47). When used in this title the term "life insurance company" means an insurance company engaged in the business of issuing life insurance and annuity contracts (including contracts of combined life, health and accident insurance), the reserve funds of which held for the fulfillment of such contracts comprise more than 50 per centum of its total reserve funds.

Sec. 243. (44 Stat. 47). In lieu of the tax imposed by section 230, there shall be levied, collected, and paid for each taxable year upon the net income of every life insurance company a tax as follows:

(1) In the case of a domestic life insurance company, 12½ per centum of its net income;

(2) In the case of a foreign life insurance

company, 12½ per centum of its net income from sources within the United States.

Section 244. (44 Stat. 47). (a) In the case of a life insurance company the term "gross income" means the gross amount of income received during the taxable year from interest, dividends, and rents.

(b) x x x x

Sec. 245. (44 Stat. 47). (a) in the case of a life insurance company the term "net income" means the gross income less—

(1) The amount of interest received during the taxable year which under paragraph (4) of subdivision (b) of section 213 is exempt from taxation under this title;

(2) An amount equal to the excess, if any, over the deduction specified in paragraph (1) of this subdivision, of 4 per centum of the mean of the reserve funds required by law and held at the beginning and end of the taxable year, x x x.

(3) The amount received as dividends (A) from a domestic corporation other than a corporation entitled to the benefits of section 262 and other than a corporation organized under the China Trade Act, 1922, x x x.

(4) An amount equal to 2 per centum of any sums held at the end of the taxable year as a reserve for dividends (other than dividends payable during the year following the taxable year) the payment of which is deferred for a period of not less than five years from the date of the policy contract;

(5) Investment expenses paid during the taxable year x x x.

(6) Taxes and other expenses paid during

the taxable year exclusively upon or with respect to the real estate owned by the company, not including taxes assessed against local benefits of a kind tending to increase the value of the property assessed, and not including any amount paid out for new buildings, or for permanent improvements or betterments made to increase the value of any property. x x x.

(7) A reasonable allowance for the exhaustion, wear and tear of property, including a reasonable allowance for obsolescence;

(8) All interest paid or accrued within the taxable year on its indebtedness, except on indebtedness incurred or continued to purchase or carry obligations or securities (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer) the interest upon which is wholly exempt from taxation under this title; and

(9) x x x x

(b) No deduction shall be made under paragraphs (6) and (7) or subdivision (a) on account of any real estate owned and occupied in whole or in part by a life insurance company unless there is included in the return of gross income the rental value of the space so occupied. Such rental value shall be not less than a sum which in addition to any rents received from other tenants shall provide a net income (after deducting taxes, depreciation, and all other expenses) at the rate of 4 per centum per annum of the book value at the end of the taxable year of the real estate so owned or occupied.

The Regulations.

Regulations 69, pertaining to the Revenue Act of 1926, provides by Article 685, subdivision (3), that—

> The deduction allowed by Section 245 (a) (8) for interest on indebtedness is the same as that allowed other corporations by Section 234 (a) (2) (See Articles 561 and 121) but this deduction includes item 18 of the disbursement page of the annual statement of life companies to the extent that interest on dividends held on deposit and surrendered during the taxable year is included therein. Dividends left with the company to accumulate at interest are a debt and not a reserve liability.